Supreme Court, U.S.
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No. 95-1534

In the Supreme Court of the United States

OCTOBER TERM, 1995

CONSTELLATION DEVELOPMENT CORPORATION,
PETITIONER

v.

JAMES F. DOWDEN, SUCCESSOR TRUSTEE,
RICHARD L. SMITH, TRUSTEE,
UNITED STATES EX REL. INTERNAL REVENUE SERVICE

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the bankruptcy court had jurisdiction under 28 U.S.C. 157(b)(1) and 28 U.S.C. 157(b)(2)(K) to determine the validity of petitioner's lien.

2. Whether petitioner's lien was invalid.

3. Whether petitioner's request for a jury trial, made for the first time at the commencement of the trial, was properly denied.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-15) is reported at 66 F.3d 931. The opinions of the district court (Pet. App. 16-17) and the bankruptcy court (Pet. App. 18-38) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on September 20, 1995. A petition for rehearing was denied on November 28, 1995. The petition for a writ of certiorari was filed on February 26, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This action arises from the involuntary bankruptcy of B.J. McAdams, Inc. (BJMI), an insolvent Arkansas trucking enterprise and one of an array of corporate entities created and controlled by Bobby Joe McAdams (McAdams). McAdams was the president, chief executive officer, and sole stockholder of BJMI. His son, Robert L. McAdams (Robert), held the title of executive vice-president of BJMI, but he was not permitted to make any business decision on his own (Pet. App. 2). McAdams maintained a large amount of cash, which he viewed as a "trust fund" for the benefit of Robert (*id.* at 6).

Parthenon Insurance Company was formed in 1986 under the laws of the British Virgin Islands purportedly to serve as a self-insurance mechanism for BJMI. Robert has been at various times director, corporate treasurer, and president/secretary of Parthenon. Parthenon's stock was held by McAdams and Robert from 1986 to 1988. Robert was effectively the sole owner of Parthenon in 1988 and 1989, until it was purportedly sold to Plentywood, Inc., a Panamanian corporation, in March 1989 (Pet. App. 3). Parthenon's capital consisted of two contributions of $125,000 each, which came from the alleged "trust fund" (*id.* at 3-4). Lacking any salaried employees of its own, Parthenon relied on BJMI's clerical and administrative staff to perform its corporate tasks, without compensating BJMI for the services. By corporate resolution, Parthenon granted BJMI the authority to "appoint such individuals as [BJMI] deemed necessary to transact certain business matters of [Parthenon]." Throughout its corporate existence, Parthenon never maintained a bank account and conducted all of its

transactions by cash or cashier's checks. McAdams made all business decisions for Parthenon on Robert's behalf (*id.* at 4).

Parthenon owned all of the stock of Constellation Development Corporation, the petitioner in this case (Pet. App. 6). Petitioner was incorporated for the purpose of making loans to BJMI (*id.* at 14). McAdams capitalized petitioner with $368,500 from the "trust fund" (*id.* at 6). Petitioner, in turn, loaned this money to BJMI (*id.* at 6-7). On the day that petitioner was incorporated, it entered into an agreement with BJMI entitled "Matching Fund and Other Type Loan(s) and Security Agreement." McAdams alone negotiated, drafted, and signed the agreement on behalf of both BJMI and petitioner. Petitioner claimed that it acquired a lien in the property of BJMI pursuant to this agreement (*id.* at 5, 7).

In an involuntary Chapter 7 petition in bankruptcy brought against BJMI, the United States filed a proof of claim against the estate in the total amount of $1,110,089.34. Petitioner asserted that it had made secured loans to BJMI in the total amount of $1,344,000, and possessed a lien against property of BJMI for that amount, plus accrued interest. Petitioner obtained the money that it purportedly lent to BJMI in a series of circular transactions: (i) $428,000 was attributable to cash insurance premium payments made by BJMI to Parthenon, and then lent to BJMI by petitioner, (ii) $208,000 was based on notes issued by BJMI to petitioner in lieu of making cash insurance payments to Parthenon, (iii) $112,500 came directly from BJMI, (iv) $368,500 was attributable to the cash used by McAdams to capitalize petitioner initially, and (v) $227,000 was attributable to additional cash from the "trust fund" (Pet. App. 7).

BJMI owned a 1977 Gates Learjet that was subject to the liens of petitioner and the Internal Revenue Service. The sale of this airplane for $1,562,050 was approved by the bankruptcy court (Pet. App. 7). The trustee commenced adversary proceedings to determine the validity, extent, and priority of the liens asserted against the proceeds of the aircraft sale and other property of the estate by petitioner and the Internal Revenue Service (*id.* at 7-8).

Petitioner filed a counterclaim against the trustee and a cross-claim against the Internal Revenue Service, contending that its lien had priority over all other liens asserted against the property (Pet. App. 18-19). Petitioner did not challenge the validity of the tax liens but, instead, asserted that its lien arose first and therefore had priority over the government's liens. The United States took the position that petitioner's lien was invalid because the underlying debt was invalid. The government also contended that petitioner was the alter ego of the debtor (*id.* at 8).

On the morning of the day that the trial was to commence, petitioner made an oral demand for a jury trial (Pet. App. 93, 98). The bankruptcy court denied that request (*id.* at 98).

2. Following the trial, the bankruptcy court concluded that the lien asserted by petitioner in the property of BJMI was void because petitioner was a mere instrumentality or alter ego of BJMI (Pet. App. 18-38). The court held that petitioner and its parent, Parthenon, were instrumentalities or alter egos of BJMI because (i) they were incorporated at the behest of McAdams, BJMI's owner, (ii) they were grossly undercapitalized, and their "businesses" and finances were inextricably intertwined with BJMI's affairs, (iii) they were, in reality, both owned and controlled

by McAdams, (iv) McAdams used Robert as a figurehead (apparently in an attempt to disguise his complete dominion and control over all of the entities), (v) neither had any reportable income, (vi) neither had any salaried employees, (vii) their administrative functions were performed by BJMI's employees, (viii) all of their expenses were borne by BJMI and (ix) they both served merely as appendages of BJMI (*id.* at 30-35). Because petitioner was a mere instrumentality or alter ego of BJMI, the court held that the alleged loans and security arrangement between petitioner and BJMI were a mere sham and that petitioner's lien was therefore invalid and void (*id.* at 36, 38). The district court affirmed (*id.* at 16-17).

3. The court of appeals affirmed (Pet. App. 1-15). The court held that, under 28 U.S.C. 157(b)(1) and 28 U.S.C. 157(b)(2)(K) and Federal Rule of Bankruptcy Procedure 7001(2), the bankruptcy trustee had standing to commence, and the bankruptcy court had jurisdiction to adjudicate, an adversary proceeding for the determination of the validity, extent, and priority of liens asserted against property of the bankruptcy estate (Pet. App. 8-12). The court found that "the evidence firmly establishes that McAdams attempted to shelter BJMI's assets from its creditors by means of a self-imposed lien" (*id.* at 15). The court concluded that "it would have been inequitable to allow BJMI to deplete the estate by paying itself at the expense of its true creditors" (*ibid.*).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. The court of appeals correctly held (Pet. App. 8-12) that the bankruptcy court had jurisdiction over the adversary proceedings in this case. Those proceedings were commenced by the bankruptcy trustee to determine the validity, extent, and priority of competing liens asserted by petitioner and the Internal Revenue Service in the property of BJMI's bankruptcy estate. An action of this nature is a core bankruptcy proceeding under 28 U.S.C. 157(b)(1) and 28 U.S.C. 157(b)(2)(K). See Federal Rule of Bankruptcy Procedure 7001(2).

The court of appeals correctly rejected petitioner's contention (Pet. 16-17) that, under *In re Ozark Restaurant Equip. Co.*, 816 F.2d 1222 (8th Cir.), cert. denied *sub nom. Jacoway* v. *Anderson* 484 U.S. 848 (1987), the bankruptcy trustee lacked standing to seek a determination of the validity of petitioner's lien. The *Ozark* court held that a bankruptcy trustee lacked standing to seek to pierce the corporate veil of a debtor in order to hold its principals liable for its debts. The court correctly concluded in this case (Pet. App. 9-10) that the holding of *Ozark* is inapposite here, for the trustee was not seeking to pierce BJMI's corporate veil but was instead seeking to determine the validity of competing liens in the debtor's property pursuant to 28 U.S.C. 157(b)(1) and 28 U.S.C. 157(b)(2)(K) and Federal Rule of Bankruptcy Procedure 7001(2).

The court of appeals also correctly rejected petitioner's contention (Pet. 17-20) that the bankruptcy court lacked jurisdiction because the liens asserted against the aircraft exceeded its value. A fundamental purpose of bankruptcy law is the resolution of competing claims against property of the bankruptcy estate. Since the aircraft and the proceeds from its

sale were property of the bankruptcy estate, the bankruptcy court had jurisdiction to determine the validity of the liens asserted against that property (Pet. App. 10-11).

2. The finding that petitioner's lien was invalid because it was based upon a sham loan was not clearly erroneous. A claim against a bankruptcy estate should be denied if it is not founded on any true debt. *Pepper* v. *Litton*, 308 U.S. 295, 306 (1939). A contrived claim asserted by an alter ego of the debtor is not to be recognized. *In re Distrigas Corp.*, 75 B.R. 770, 774 (Bankr. D. Mass. 1987). Under the "alter ego" doctrine, the legal fiction of the separate corporate entity is to be disregarded in the case of a corporation that (i) is controlled by another to the extent that it has independent existence in form only and (ii) is used as a subterfuge to defeat public convenience, to justify wrong, or to perpetrate a fraud. *Chicago, M. St. P. Ry.* v. *Minneapolis Civic & Commerce Ass'n*, 247 U.S. 490, 501 (1918); *Lakota Girl Scout Council, Inc.* v. *Havey Fund-Raising Management, Inc.*, 519 F.2d 634, 638 (8th Cir. 1975). "The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside." *Pepper* v. *Litton*, 308 U.S. at 306-307.

The evidence compelled the conclusion of the courts below (Pet. App. 12-15, 16-17, 34-35, 38) that petitioner's lien was not founded upon any true debt. Petitioner was created by McAdams—who also owned and controlled BJMI—for the purpose of obtaining a security interest in BJMI's assets. McAdams handled the purported loan transactions for both petitioner and BJMI. The money that petitioner allegedly lent to BJMI originated from BJMI in the first instance.

The transaction possessed none of the characteristics of a bona fide, arm's length bargain.

Each of the three courts below concurred in the conclusion that the claim asserted by petitioner in this case was not based upon a bona fide debt. Further review of that factual determination is not warranted. See, *e.g.*, *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985).

3. Petitioner contends (Pet. 9-15) that the bankruptcy court erred in rejecting petitioner's oral demand for a jury trial, first asserted on the morning that the trial was to commence (Pet. App. 93, 98). But petitioner waived that issue by not raising it in its appeal to the district court. *United States* v. *Olson*, 4 F.3d 562, 567 (8th Cir.), cert. denied *sub nom. Needler* v. *Olson*, 114 S. Ct. 636 (1993); *Mountain America Credit Union* v. *Skinner*, 917 F.2d 444, 446 (10th Cir. 1990).

Petitioner also failed to raise the denial of petitioner's belated jury trial demand as an issue in its appeal to the court of appeals. Because that issue was not raised in, or addressed by, the court of appeals, it is not properly before this Court. See *Adickes* v. *Kress & Co.*, 398 U.S. 144, 147 n.2 (1970) ("Where issues are neither raised before nor considered by the Court of Appeals, this Court will not ordinarily consider them."); *County of Oneida* v. *Oneida Indian Nation*, 470 U.S. 226, 245 (1985) ("While petitioners argued at trial that the Oneidas were guilty of laches, the District Court ruled against them and they did not reassert this defense on appeal. As a result, the Court of Appeals did not rule on this claim, and we likewise decline to do so."). Accord, *United States* v. *Williams*, 504 U.S. 36, 41 (1992); *Taylor* v. *Freeland*

& Kronz, 503 U.S. 638, 646 (1992); *City of Springfield* v. *Kibbe*, 480 U.S. 257, 266 (1987).[1]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[1] In any event, petitioner errs in contending (Pet. 9-15) that it was entitled to a jury trial in this case under *Granfinanciera, S.A.* v. *Nordberg*, 492 U.S. 33 (1989). In *Granfinanciera*, the bankruptcy trustee claimed in an adversary proceeding that the defendants had received property of the bankruptcy estate through fraudulent conveyances. The trustee sought to set aside the fraudulent conveyances and to bring the property back into the bankruptcy estate. This Court held that, in those circumstances, the defendants were entitled to a jury trial. The present case is distinguishable from *Granfinanciera*. While the trustee in *Granfinanciera* was attempting to bring disputed property into the bankruptcy estate, in this case, the bankruptcy trustee merely desired to resolve competing claims against property that unquestionably was property of the bankruptcy estate. Issues that arise as part of the allowance or disallowance of claims respecting property in the bankruptcy estate do not give rise to a right of trial by jury. See 492 U.S. at 57-58; *Katchen* v. *Landy*, 382 U.S. 323, 336 (1966).